FILED
JAN 6 1984
ALEXANDER L. STEVAS
CLERK

No. 82-687

In the Supreme Court of the United States

OCTOBER TERM, 1983

UNITED STATES OF AMERICA, PETITIONER

v.

ARTHUR YOUNG & COMPANY, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

1. The holding of the court of appeals, that tax accrual workpapers are privileged from production pursuant to an IRS summons issued under 26 U.S.C. 7602,[1] was based on what the court saw as its "require[d]" role "to balance strong public policies against a party's need for information whenever a conflict between the two arises" (Pet. App. 28a). Respondents ask this Court to engage in the same balancing. We do not think, however, that federal courts have so broad a license to pick and choose among competing policies or to deny enforcement to government demands for information pursuant to statutory provisions enacted by Congress. Compare, *e.g.*, *United States* v. *Euge*, 444 U.S. 707, 713 (1980), quoting *United States* v. *Bryan*, 339 U.S. 323, 331 (1950) (exemption from testimonial obligations "grounded in a substantial individual interest which has been found, through centuries of experience, to outweigh the public interest in the search for truth").[2] In any event, the justifications advanced by the

[1] The decision below is contrary to the decisions of every other court that has considered the issue (see U.S. Br. 36-39) and has recently been rejected by the Eleventh Circuit. See *Matter of Newton*, 718 F.2d 1015, 1020-1021 (1983); see also *United States* v. *I.C. Industries, Inc.*, 555 F. Supp. 219, 222-223 (N.D. Ill. 1983).

[2] Respondents can be read to suggest (Arthur Young (AY) Br. 21-22; Amerada Hess (AH) Br. 21-24) that Fed. R. Evid. 501

court of appeals and renewed by respondents—the perceived unfairness of allowing IRS access to tax accrual workpapers and the asserted conflict between the federal tax and securities laws—are insufficient to warrant the judicial establishment of an accountant privilege. If such a privilege is to be created, it should be done by Congress, which is best suited to weighing the competing statutory objectives and gathering the facts necessary to reach a sound and informed decision.[3]

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affirmatively charges and encourages the courts to create new privileges. But, as the Rule explicitly provides, privileges are to "be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience." As discussed in our opening brief (at 15, 17), the creation of privileges is not favored, and a heavy burden rests on the proponent to justify the need for the privilege. Federal law has never recognized an accountant privilege, and no such privilege was enumerated in the proposed version of the Federal Rules of Evidence or advanced in the hearings on the Rules. See 56 F.R.D. 183, 230, 233 (1973); *Proposed Rules of Evidence: Hearings Before the Special Subcomm. on Reform of the Criminal Laws of the House Comm. on the Judiciary*, 93d Cong., 1st Sess. (1973); see also 8 J. Wigmore, *Evidence* § 2286, at 536-537 (McNaughton rev. ed. 1961) (rejection of accountant privilege by Model Code of Evidence, Uniform Rules of Evidence, and American Bar Association). In substituting the current Rule 501 for the enumeration of specific privileges in the proposed Rules, Congress primarily sought to permit state evidentiary rules to govern the question of privilege in connection with state-law issues in diversity cases (see S. Rep. 93-1277, 93d Cong., 2d Sess. 6-7, 12 n.17 (1974)); although Rule 501 also provides flexibility with regard to federal privileges, Congress did not intend to override the well-established principles disfavoring the creation of new privileges. See *United States* v. *Gillock*, 445 U.S. 360, 367-368 (1980). And nowhere in the course of enacting Rule 501 did Congress indicate an intent to override the analysis in *St. Regis Paper Co.* v. *United States*, 368 U.S. 208 (1971), that a statute should not be read as creating a new privilege unless it clearly so provides (see U.S. Br. 43; page 8, *infra*).

[3] Respondents cite (AY Br. 3-4 n.3; AH Br. 16-17 & n.*, 19, 30) a number of articles in support of their position. In the main these were written by lawyers and accountants in private tax practice and therefore do not necessarily represent a neutral and detached assessment of the issue. In addition, respondents largely

a. Respondents contend (Arthur Young (AY) Br. 3, 10, 12-16; Amerada Hess (AH) Br. 6-11) that it would be "fundamentally unfair" to permit the IRS to have access to tax accrual workpapers. We submit that it is not at all unfair to allow the IRS access to these relevant materials prepared in connection with an independent audit by an independent accountant.

Respondents' claim of unfairness must be viewed "against the familiar background that our tax structure is based on a system of self-reporting. There is legal compulsion, to be sure, but basically the Government depends upon the good faith and integrity of each potential taxpayer to disclose honestly all information relevant to tax liability." *United States* v. *Bisceglia*, 420 U.S. 141, 145 (1975). Under the revenue laws, taxpayers are required to collect and reveal a great deal of information that may ultimately be to their disadvantage. While such duties "involve some invasion of privacy, they are essential to our self-reporting system" (*id.* at 146). Thus, respondents seek a privilege "in the very situation where obligations of disclosure exist and under a system largely dependent upon honest self-reporting even to survive." *Couch* v. *United States*, 409 U.S. 322, 335 (1973).

Of course, a taxpayer has no duty to maximize its tax liability. But the taxpayer's obligation is not merely to pay such amounts as the IRS is capable of enforcing. A taxpayer—unlike a litigant (compare *Hickman* v. *Taylor*, 329 U.S. 495 (1947))—is not free to play its cards close to its vest in the hope of going undetected or to turn the tax system into "a sophisticated game of hide and seek."

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ignore the authorities that go against their position. See, *e.g.*, 2 Weinstein & Berger, *Weinstein's Evidence* 146-147, 175 (Dec. 1982 Supp.); Jacobson & Steel, *The Auditor Work-Product Privilege*, 16 Review of Securities Regulation 892 (May 18, 1983); Note, *Tax Accrual Workpapers and IRS Summonses Under IRC § 7602: The Accountant Work-Product Privilege*, 48 Mo. L. Rev. 825 (1983).

United States v. *Price Waterhouse & Co.*, 515 F. Supp. 996, 1000 (N.D. Ill. 1981).[4]

Respondents' claim of privilege is also at odds with the fundamental premises underlying the regulation of publicly held corporations under the securities laws. Under the securities laws corporations like Amerada Hess are required to develop and disclose to the public and the government a full range of information bearing on the company's financial health. Cf. *Shapiro* v. *United States*, 335 U.S. 1 (1948). As discussed in our opening brief (at 3, 21, 29-33, 36-37), the principal instrument for such disclosure is the *independent* audit to be performed by the *independent* certified public accountant. That accountant owes his primary duty of loyalty not to the client but to the shareholders, the creditors, and the government—in sum, to the public. Independent public accountants are, in this context, an instrument of visitation and oversight. They do not function like lawyers, who owe undivided loyalty to the client and whose primary function is to give the client confidential advice. (Also to be distinguished is the role of the accountant when he is giving tax advice—

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[4] As outlined in our opening brief (at 27), the practical burdens on the IRS in conducting tax audits are enormous and should not be underestimated—especially in the case of annual audits of large multinational corporations. It may be, as respondents state (AY Br. 2, 26; AH Br. 2)—although no findings were made below in this regard—that the tax accrual workpapers do not contain facts that are not otherwise available in Amerada Hess's records or public documents. But that does not mean that the information is to be found in files that are actually produced by the taxpayer. For instance, with respect to a depreciation deduction, it might be necessary to compare the tax treatment in a given year to that over a number of previous years or to the actual useful life of similar items in the taxpayer's experience—information that might not be obtained in the ordinary course of a routine tax audit for particular years. And even if the source files are requested, the salient information buried among the details in that file will not, as a practical matter, necessarily be evident to the IRS agent. An accountant privilege would bar the IRS from effectively and efficiently enforcing the revenue laws by requesting information from more than one source or in the most intelligible and useable form in which it exists.

sometimes as part of a "team" with the client's attorneys —in connection with the preparation of the client's tax return. It is only a coincidence—and, in view of possible conflicts of interest, perhaps an undesirable one—if the same accounting firm that gave "aggressive" tax advice in connection with the preparation of a return is also doing the "independent" audit.) When engaged in the independent audit the accountant is not to be seen as the client's confidential agent. Consequently, no considerations of "fairness" point in the direction of shielding, from the public gaze, the flow of information that passed between the client and the independent accountant in connection with the preparation of this audit.

The point can be illuminated by supposing that the audit was conducted not by the client's "regular" accounting firm, but by an "outside" auditor selected by the Securities and Exchange Commission. Or suppose the securities laws directed the SEC itself to conduct the audit. In such circumstances no claim could be made that "fairness" requires that the IRS be barred from access to tax accrual workpapers prepared in connection with the audit. Similarly, if a tax accrual audit were made by outside lenders asked by the company to provide it with financing,[5] it is clear that no claim of privilege could possibly be raised to prevent the IRS from summoning the resulting workpapers. But the claim of unfairness in this case is no stronger. Here, too, the central point is that the communications between the client and the independent auditor—and the material generated by the auditor based on those communications—arise not in the context of confidential relationships created for the benefit of the client, but in the context of an investigatory and oversight relationship created in order to provide accurate public disclosure of the client's financial condition.

The same point is relevant to show that the IRS is not here attempting to invade the thoughts and strategies of

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[5] See U.S. Br. 28; *Matter of Newton*, 718 F.2d at 1017 n.2; *United States* v. *El Paso Co.*, 682 F.2d 530, 534 n.3 (5th Cir. 1982), petition for cert. pending, No. 82-716.

a prospective opponent in an adversary proceeding—the traditional justification for the work-product rule. The tax accrual workpapers were prepared in connection with Amerada Hess's obligations under the federal securities laws. They were not prepared in contemplation of an adversarial relationship with the IRS. While the workpapers may discuss Amerada Hess's potential tax problems, they were not prepared as part of the process of resolving disputes with the IRS, and the auditor's role in preparing these papers is quite antithetical to the role of lawyers (and accountants) helping a client to resolve disputes with the IRS. The work-product doctrine turns on the purpose for which a document was *prepared*, not the purpose for which it is sought; the fact that a controversy may be emerging between the taxpayer and the IRS at the time the summons is issued does not transform into work-product the tax accrual file that was previously prepared pursuant to the securities laws.

Nor do the contents of the tax accrual workpapers call for the creation of a privilege. The IRS seeks access to documents that are clearly relevant (see pages 17-19, *infra*) to the determination of the correctness of Amerada Hess's tax returns and are regularly prepared in the ordinary course of business in order for Amerada Hess to engage in public securities activities. More specifically, the IRS seeks existing documents that explain the representation that has been made to the public pursuant to federal securities laws that the reserves set aside by the taxpayer are necessary and sufficient to cover its contingent tax liability.[6] It does not offend traditional notions of fair play and justice for the IRS, in administering the self-reporting tax system, to review the materials underlying that representation, any more than it would to give

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[6] In fact, the reserve is required to include only those contingent liabilities that are "probable" and "can be reasonably estimated" in amount. Financial Accounting Standards Board, *Statement on Accounting Standards No. 5: Accounting for Contingencies* § 8 (1975). Thus, inclusion of a contingent tax liability in the reserve indicates that there is a substantial question about the correctness of the taxpayer's return.

the IRS access to ordinary corporate memoranda prepared in the regular course of business (*e.g.*, in anticipation of a stockholders' meeting at which the company's financial situation will be discussed) that contain an analysis of the company's contingent tax liabilities.

The creation of a privilege would be especially inappropriate here because the documents in question were prepared by the independent public auditor with the very idea that they would be subject to disclosure in the event of a challenge under the securities laws. See U.S. Br. 31-33. There can be no question, and respondents do not contend otherwise, that tax accrual workpapers could be examined by the SEC or a private plaintiff in a securities proceeding. These materials should not be cloaked in a confidential mantle in this case simply because it is the IRS that seeks them for a relevant purpose. Given the significant possibility of disclosure that exists entirely beyond the control of the taxpayer or the auditor, it would be unjustified to treat these documents as privileged with respect to the IRS.[7]

b. Respondents also contend (AY Br. 8, 19-20; AH Br. 14-20) that IRS access to tax accrual workpapers would interfere with the objectives of the federal securi-

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[7] We point out that, for the future, the IRS has established guidelines applicable to requests for tax accrual workpapers in civil investigations. See *Guidelines for Requesting Audit or Tax Accrual Workpapers*, [Audit] 1 Int. Rev. Man. (CCH) ¶ 4024.4 (May 14, 1981). While these internal guidelines are not binding and do not give rise to enforceable rights (see, *e.g.*, *United States* v. *I.C. Industries, Inc.*, 555 F. Supp. at 222; *United States* v. *Price Waterhouse & Co.*, 515 F. Supp. at 999; *United States* v. *Arthur Andersen & Co.*, 474 F. Supp. 322, 331 (D. Mass. 1979), appeal of one party dismissed, 623 F.2d 720 (1st Cir.), cert. denied, 449 U.S. 1021, aff'd as to second party, 623 F.2d 725 (1st Cir. 1980)), they do reflect the IRS's sensitivity to and efforts to satisfy the objections that have been raised to summonses for tax accrual workpapers. (The guidelines do not apply to criminal (or joint civil-criminal) investigations, and thus would have been irrelevant to this case even if they had been promulgated when this summons was issued.) The standards set forth in the guidelines are not as restrictive as the qualified privilege that the court below appeared to contemplate (see Pet. App. 31a-32a & n.10).

ties laws and that this tension should be resolved in favor of the primacy of the securities statutes.

A statutory privilege is not to be recognized, however, "unless the statute, strictly construed, requires such a result." *St. Regis Paper Co.* v. *United States*, 368 U.S. 208, 218 (1961). Cf. *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 633-634 (1981); *Local 1976, United Brotherhood of Carpenters* v. *NLRB*, 357 U.S. 93, 111 (1958). Consequently, as discussed in our opening brief (at 42-44), the court of appeals erred in elevating the vague emanations it found in the securities laws over the clear and express authority of the IRS to summon relevant records.

These emanations were based on the highly speculative and conjectural proposition that IRS access to tax accrual workpapers *might* have *some* effect in decreasing the candor of communications between *some* taxpayers and auditors in *some* circumstances (see Pet. App. 29a-30a). We note, again, that the proposition proves too much: it would require shielding tax accrual workpapers developed during an audit even where it is conducted by an "outside" auditor—one picked by the SEC or by creditors or prospective investors.

In any event, this is far too slender a reed on which to limit IRS access under Section 7602. There is serious doubt whether the independent audit process will be impaired by the absence of an accountant privilege for tax accrual workpapers. See U.S. Br. 39-42.[8] A publicly-

[8] Some commentators have noted that the independent audit process is enhanced by the lack of an accountant privilege and that it is the decision below that threatens to impair that process. See, *e.g.*, Jacobson & Steel, *The Auditor Work-Product Privilege*, 16 Review of Securities Regulation 891, 897 (May 18, 1983) ("Public confidence in the audit process may be diminished rather than enhanced by the *Arthur Young* result. The existence of the privilege * * * could put undue pressure on auditors to bend to client pressure, or at least a public perception of such pressure. If the audit trail is shrouded in secrecy, the audit's integrity may be open to question"); Note, *Tax Accrual Workpapers and IRS Summonses Under IRC § 7602: The Accountant Work-Product Privilege*, 48 Mo. L. Rev. 825, 832-833 (1983) ("For the public to have * * * faith

held corporation like Amerada Hess is required by law to file accurate and complete financial statements that have been certified by an independent auditor. This legal duty —and the serious consequences of failing to comply—provides substantial assurance of the adequacy of the audit process irrespective of any privilege. Further, the auditor is obligated to follow generally accepted standards—including requirements with respect to access to adequate information on which to base its opinion—and has effective means at its disposal to obtain the cooperation of the taxpayer. Since accounting standards require that workpapers be prepared and retained, and since a principal purpose of the workpapers is to provide information and protection for the auditor in the event of a later challenge,[9] there is little reason to believe, as the court of appeals feared (Pet. App. 25a), that the possibility of IRS access would induce auditors not to keep such papers.

Finally, in assessing the impact of declining to create an accountant privilege, it should be recognized that there already exist temptations for the taxpayer to try to confine the scope and thoroughness of the independent audit. Public disclosure of a contingent tax liability can have an adverse effect on a company's financial statement, and the taxpayer may seek therefore to minimize the reserve that the auditor finds to be required. Given the inherent tensions that exist between the taxpayer and the auditor, there is considerable doubt whether the incremental con-

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in the reliability of a corporation's financial statements, it is necessary for them to perceive the auditor as an independent professional. * * * A privilege for auditors would tend to destroy the appearance of independence by creating the impression that the auditor is an advocate for the client. Thus, the work-product privilege would seem to do more harm than good to the audit process * * *"). In fact, the absence of a privilege will help to ensure a strict separation between the functions of tax advice on the one hand and tax audits on the other, and thereby safeguard the independence of the audit process.

[9] See, *e.g.*, Wixon, Kell, & Bedford, *Accountants' Handbook* 26:19-26:21 (5th ed. 1970); Report, *A Qualified Privilege for Tax Accrual Workpapers*, 39 Bus. Law. 247, 255 n.31 (1983).

sequences of the absence of an accountant privilege would significantly affect the public audit process.[10]

c. To the extent that the desirability of an accountant privilege is debatable, that debate should be resolved by Congress as the policymaking branch of government. See, *e.g.*, *United States* v. *New Mexico*, 455 U.S. 720, 737-738 (1982); *Diamond* v. *Chakrabarty*, 447 U.S. 303, 317 (1980); *United States* v. *Gillock*, 445 U.S. 360, 374 (1980); *Branzburg* v. *Hayes*, 408 U.S. 665, 693-694, 706 (1972). Congress rather than the federal judiciary is the appropriate body to strike the balance between the conflicting policies—if they are conflicting—of the tax and securities laws. Congress also is better situated to gather and analyze the facts pertaining to the necessity for and scope of an accountant privilege. These would include, on the one hand, the IRS's need for access to tax accrual workpapers and the effect on its enforcement workload and resources of denying such access; and, on the other, the "chilling" effect that the absence of a privilege might have on the independent auditing process and its consequences for the investing public, the preconditions for and bounds of the privilege, and the establishment of judicial and administrative procedures (including the possibility of in camera review in district court) to implement the privilege.

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[10] *Upjohn Co.* v. *United States*, 449 U.S. 383 (1981), upon which respondents rely (AH Br. 19), does not suggest a contrary conclusion. See U.S. Br. 42 n.25. In *Upjohn*, the corporation was under no legal duty to disclose to its attorney the information sought to be protected by the privilege, and its attorney was neither required nor given the authority by law to uncover that information on its own. In contrast, Amerada Hess does have the legal duty—regardless of privilege—to make a full and correct disclosure to the independent public auditor, and the auditor is obligated and provided with effective means to enable it to obtain the necessary information. For these reasons, the Court's concern in *Upjohn* that the "depth and quality of any investigations to ensure compliance with the law would suffer" in the absence of a privilege (449 U.S. at 393 n.2) is inapplicable here. Rather, it is the requirements of the securities laws, not an accountant privilege, that ensure the adequacy of the public accounting process.

In advancing this argument, we do not contend, as respondents characterize it (AY Br. 21-22; AH Br. 21-24), that the courts lack "power" to recognize an accountant privilege. Rather, we suggest that, in light of the speculative nature of the court of appeals' reasoning and its reliance on a supposed conflict between two federal statutory schemes, Congress is in a better position than the judiciary to decide whether a novel accountant privilege is needed to limit the broad statutory summons authority of the IRS. See *Matter of Newton*, 718 F.2d at 1021.[11]

2. Respondents contend (AY Br. 26-31; AH Br. 35-42) that the judgment below may be affirmed on the alternate

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[11] Notwithstanding respondents' argument (AY Br. 18 n.12; AH Br. 30-32), Congress did not resolve the issue in the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 323(a), 96 Stat. 324, 613, which provides a penalty for substantial understatement of income tax unless there is substantial authority for the taxpayer's position or the relevant facts were disclosed by the taxpayer on its return. TEFRA does not answer the question presented here. First, there is no indication that Congress intended to resolve the issue of IRS summons authority; TEFRA speaks to the routine requirements for all tax returns and does not address the narrower class of cases in which an audit is conducted and a summons issued. Furthermore, the sentence in S. Rep. 97-494, 97th Cong., 2d Sess. 274 (1982), upon which respondents heavily rely, was deleted in the Conference Report, H.R. Conf. Rep. 97-760, 97th Cong., 2d Sess. 575-576 (1982). Finally, and perhaps most importantly, the penalty provision in Section 323(a) of TEFRA is not self-enforcing but instead requires the IRS to uncover those taxpayers that substantially underreport their taxes—a matter handled by the investigation and summons process. Thus, the existence of the penalty and its exemption for the disclosure of relevant facts do not in any way suggest that Congress intended to cut back on the IRS's authority to investigate in cases in which such disclosure was not made. Indeed, in other sections of TEFRA explicitly involving the IRS's summons power, Congress generally expanded rather than restricted that power. See H.R. Conf. Rep. 97-760, *supra*, at 583-584. There is no indication in TEFRA that Congress sought to limit the IRS's authority to summon tax accrual workpapers or that it was aware of and meant to choose between, on the one hand, the decisions in this case and *United States* v. *Coopers & Lybrand*, 413 F. Supp. 942 (D. Colo. 1975), aff'd, 550 F.2d 615 (10th Cir. 1977), and, on the other, those in *Arthur Andersen*, *Price Waterhouse*, and *El Paso Co.*

ground that, as a matter of law, tax accrual workpapers are not relevant under 26 U.S.C. 7602. Both courts below correctly rejected this contention (Pet. App. 6a-8a, 26a-27a). See U.S. Br. 21-28.[12]

Section 7602(1) and (2) of the Internal Revenue Code (26 U.S.C.) provides that the IRS is authorized to summon and examine "any books, papers, records, or other data *which may be relevant* or material to [its] inquiry" (emphasis added). All the courts of appeals are in agreement that the standard of relevance under Section 7602 is whether the documents sought "might throw light upon" the IRS's inquiry into the correctness of the taxpayer's return.[13]

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[12] There is some question whether this issue, which was not presented in our petition, is properly raised by respondents in the absence of a granted cross-petition. (The cross-petition that Arthur Young did file (No. 82-837), which remains pending, does not raise the issue of the relevance of tax accrual workpapers.) The rule is well settled "that a party must cross-appeal or cross-petition if he seeks to change the judgment below or any part thereof. An argument which would modify the judgment even in a way that provides less relief cannot be presented without filing a cross-appeal or cross-petition." Stern & Gressman, *Supreme Court Practice* 478 (5th ed. 1978). See, *e.g.*, *Andrus* v. *Idaho*, 445 U.S. 715, 725 n.6 (1980); *United States* v. *New York Telephone Co.*, 434 U.S. 159, 166 n.8 (1977); *FEA* v. *Algonquin SNG, Inc.*, 426 U.S. 548, 560 n.11 (1976); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 381 n.4 (1970). The ruling below held that the tax accrual workpapers need not be produced in this case because the qualified privilege created by the court of appeals had not been overcome (see Pet. App. 32a); in contrast, a determination that the materials are not relevant would constitute an absolute ground for nonproduction regardless of any showing that the IRS might make. Moreover, if respondents' contention were accepted, it would be appropriate to remand the case for further proceedings to consider whether the tax accrual workpapers, although not relevant in their entirety, may be relevant in any part. Nevertheless, given that the issue of relevance was decided by the courts below and has been briefed in this Court, and given the analytical relationship between respondents' arguments and the question of privilege that is presented in our petition, we have no objection if the Court wishes to reach the issue of relevance.

[13] See, *e.g.*, *United States* v. *Freedom Church*, 613 F.2d 316, 321 (1st Cir. 1979); *United States* v. *Noall*, 587 F.2d 123, 125 (2d

This standard reflects the broad statutory authority conferred upon the IRS to conduct audits. The IRS need not have probable cause to believe that additional taxes are due, but rather " 'can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.' " *United States* v. *Powell*, 379 U.S. 48, 57 (1964) (citation omitted). Furthermore, "Congress[] inten[ded] to provide the [IRS] with broad latitude to adopt enforcement techniques helpful in the performance of [its] tax collection and assessment responsibilities * * *." *United States* v. *Euge*, 444 U.S. 707, 716 n.9 (1980). And of course, until it has seen them, the IRS cannot be certain that the requested materials will in fact bear on the correctness of the taxpayer's return, and therefore it can do no more than seek documents that "may be relevant" to its investigation (26 U.S.C. 7602). See U.S. Br. 23-24 & n.11.[14]

Cir. 1978), cert. denied, 441 U.S. 923 (1979); *United States* v. *Garden State National Bank*, 607 F.2d 61, 68-70 (3d Cir. 1979); *United States* v. *Richards*, 631 F.2d 341, 345 (4th Cir. 1980); *United States* v. *El Paso Co.*, 682 F.2d 530, 537 (5th Cir. 1982), petition for cert. pending, No. 82-716; *United States* v. *Will*, 671 F.2d 963, 966 (6th Cir. 1982); *United States* v. *Kis*, 658 F.2d 526, 537 (7th Cir. 1981), cert. denied *sub nom. Salkin* v. *United States*, 455 U.S. 1018 (1982); *United States* v. *Matras*, 487 F.2d 1271, 1274 (8th Cir. 1973); *United States* v. *Ryan*, 455 F.2d 728, 733 (9th Cir. 1971); *United States* v. *Southwestern Bank & Trust Co.*, 693 F.2d 994, 996 (10th Cir. 1982); *Matter of Newton*, 718 F.2d 1015, 1019 (11th Cir. 1983); see also *United States* v. *I.C. Industries, Inc.*, 555 F. Supp. 219, 221 (N.D. Ill. 1983).

[14] Amerada Hess notes (AH Br. 37-38) that some courts have added that there must be a realistic expectation, and not simply an idle hope, that the summoned information will assist in determining the taxpayer's correct tax liabilities. We doubt that this addition represents a substantive variation in the standard of relevance. It is simply a common-sense explication of an implicit element of the relevancy test. The "might throw light upon" and the "realistic expectation" formulations are not inconsistent; they are routinely applied together and treated as a single standard.

Respondents assert (AH Br. 2, 37-39; see also AY Br. 2-3, 8-9, 26) that the customary standard of relevance is inapplicable here because the summons was issued to a third party (the accounting

In arguing that tax accrual workpapers are not relevant under 26 U.S.C. 7602, respondents propose a new standard of "'sufficient relevance'" that involves "a

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firm) rather than to the taxpayer, because the tax accrual workpapers were not used in the preparation of the tax returns under audit, and because the factual information contained in the tax accrual workpapers may be in other records of Amerada Hess or public documents that are available to the IRS. However, given the breadth of Section 7602 (see, *e.g.*, *United States* v. *Euge*, 444 U.S. at 712-716) and its applicability to third parties as well as taxpayers (see, *e.g.*, *United States* v. *Bisceglia*, *supra*), we doubt that the fact a summons is issued to a third party instead of to the taxpayer has decisive significance to the issue of relevance. In any event, the court of appeals was correct in concluding that in this case Arthur Young "is not a stranger to Amerada's concerns * * *. [It] was hired to investigate Amerada's financial affairs, and to involve itself in matters that were likely to be the object of governmental inquiry" (Pet. App. 22a). Thus, in the circumstances presented here, Arthur Young does not fall within any special rule for third parties that might exist. See U.S. Br. 23 n.10.

The court of appeals also correctly rejected the argument that documents are not relevant if they were not used in preparing the taxpayer's return (Pet. App. 27a). See U.S. Br. 23 n.10, 39 n.23. Materials not used in a tax return unquestionably "may be relevant * * * [to the Commissioner's] inquiry" under Section 7602, and courts have enforced summonses for such materials. See, *e.g.*, *United States* v. *Euge*, *supra* (exemplar of taxpayer's handwriting); *Donaldson* v. *United States*, 400 U.S. 517 (1971) (employment applications and background data); *United States* v. *New York Telephone Co.*, 644 F.2d 953 (2d Cir. 1981) (telephone company billing records); *United States* v. *Wyatt*, 637 F.2d 293, 300 (5th Cir. 1981) (evidence relating to illegal payments whether or not deducted on the returns); *United States* v. *Noall*, 587 F.2d at 125-126 (internal audit data not used in preparation of returns); *United States* v. *Cleveland Trust Co.*, 474 F.2d 1234 (6th Cir.), cert. denied, 414 U.S. 866 (1973) (net worth statements submitted to bank with loan application); see also *United States* v. *Southwestern Bank & Trust Co.*, 693 F.2d 994 (10th Cir. 1982); *United States* v. *Norcutt*, 680 F.2d 54 (8th Cir. 1982).

Finally, even accepting respondents' statement that the information in the tax accrual files may be found in other sources, this does not suggest that the files are not relevant or that they have in effect already been disclosed to the IRS. Documents do not lose their relevance and become immune from production simply because they collect, summarize, or analyze information that may be uncovered elsewhere in a less convenient or intelligible form—

matter of judgment and degree in light of the particular circumstances of the case," including "the degree of intrusion into a third party's files, the type of materials requested and a balancing of public policies with respect to disclosure" (AH Br. 37; see also AY Br. 29-31). This proposal to alter the traditional test of relevance is unsound for two fundamental reasons.

First, respondents' standard is divorced from the defining characteristic of relevance as a logical relationship between the materials in question and the inquiry at hand. Instead, respondents seek to import into the concept of relevance a host of policy considerations that are customarily and more appropriately treated under other doctrines such as privilege; indeed, many of the concerns identified by respondents as addressed to relevance are also advanced in support of their argument for the creation of an accountant privilege. Such "double counting" is unnecessary and improper. There is no reason to require courts to undertake the same analysis twice under two different headings. The issue of relevance is not independently illuminated by an assessment of factors like intrusiveness, burden, the sensitivity of confidential information or relations, and similar competing policies involved in balancing the needs for disclosure and nondisclosure; these considerations are better handled by other doctrinal means such as privilege.

Second, respondents' proposal represents an amorphous and complex standard that is ill-conceived for resolving the recurring and essential issue of the relevance of an IRS summons. If adopted, respondents' standard would needlessly burden the summons process, would lead to increased uncertainty and litigation, and would greatly delay the completion of the "summary enforcement proceeding." *Donaldson* v. *United States*, 400 U.S. 517, 529

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especially where, as here, the tax accrual workpapers may cast doubt upon the reliability of the taxpayer's records. See, *e.g.*, *United States* v. *Silvestain*, 668 F.2d 1161, 1163 (10th Cir. 1982); *United States* v. *Daffin*, 653 F.2d 121, 124 (4th Cir. 1981); *United States* v. *Davis*, 636 F.2d 1028, 1037-1038 (5th Cir.), cert. denied, 454 U.S. 862 (1981).

(1971); see also *United States* v. *LaSalle National Bank*, 437 U.S. 298, 316 (1978). For these reasons, respondents' standard should be rejected.

In applying the traditional standard of relevance to tax accrual workpapers, every court but one to consider the issue has agreed with the decision below that such materials are relevant within the meaning of Section 7602.[15] These decisions are plainly correct. The workpapers would clearly be relevant under the conventional standard

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[15] See *Matter of Newton*, 718 F.2d at 1018-1020; *United States* v. *El Paso Co.*, 682 F.2d at 536-538; *United States* v. *Price Waterhouse & Co.*, 515 F. Supp. 996, 999-1000 (N.D. Ill. 1981); *United States* v. *Arthur Andersen & Co.*, 474 F. Supp. 322, 329-330 (D. Mass. 1979), appeal of one party dismissed, 623 F.2d 720 (1st Cir.), cert. denied, 449 U.S. 1021, aff'd as to second party, 623 F.2d 725 (1st Cir. 1980); cf. *In re Grand Jury Subpoenas Duces Tecum (Charles Rice)*, 483 F. Supp. 1085, 1088-1089 (D. Minn. 1979) (grand jury subpoena for tax accrual workpapers).

The one case to the contrary is *United States* v. *Coopers & Lybrand*, 413 F. Supp. 942, 947-954 (D. Colo. 1975), aff'd, 550 F.2d 615, 619-621 (10th Cir. 1977), which turned on its particular facts. In that case, the government advanced four principal reasons for seeking the tax accrual workpapers. The taxpayer introduced evidence to rebut that showing, and the government "did not seek to refute this contention, but then took the position that the [workpapers] might shed some light on other, yet unidentified, areas of tax liability" (413 F. Supp. at 951). Based on this record, the district court denied enforcement, concluding that there had to be "some justifiable expectation that the information sought is relevant to the purpose of the inquiry" (*id.* at 952) and that "the term 'relevance' connotes and encompasses more than 'convenience'" (*id.* at 947, citing *United States* v. *Matras*, 487 F.2d at 1275). The court of appeals affirmed, stating that "a district court's determination that a summons should not issue must stand unless determined to be clearly erroneous" (550 F.2d at 620). To the extent that the opinions in *Coopers & Lybrand* can be read to have broader implications, they have been rejected, as noted above, by every other court to consider the issue of tax accrual workpapers. See also *United States* v. *Noall*, 587 F.2d at 126-127. Furthermore, insofar as *Coopers & Lybrand* depended upon the fact the workpapers had not been used in the preparation of the taxpayer's return (413 F. Supp. at 950, 952, 954; 550 F.2d at 619, 621), it has not been followed by other circuits or by the Tenth Circuit in subsequent cases. See U.S. Br. 39 n.23; see also page 14 note 14, *supra*.

for civil discovery in Fed. R. Civ. P. 26(b)(1); surely the IRS has no lesser authority under Section 7602.[16]

Tax accrual workpapers are relevant in several ways. See U.S. Br. 24-27. First, respondents recognize (AY Br. 2, 26; AH Br. 2) that these workpapers contain factual information; "tax accrual papers * * *, even though they consist in part of projection and hypotheses, also deal with facts and figures that form the basis of Amerada's tax liability, which the IRS desires to verify" (Pet. App. 9a). And the workpapers can be expected to present the relevant information in an organized and coherent way (see U.S. Br. 25-26); the fact that the same information may also be found in some form scattered throughout the taxpayer's voluminous files, as respondents represent (see page 4 note 4, *supra*), surely does not undermine its relevance.

In addition, tax accrual workpapers can include admissions or concessions by the taxpayer as to its tax liability. As the court of appeals noted (Pet. App. 29a), included in the information the taxpayer discloses to its independent auditor may be "questionable positions [it took] on [its] tax returns." Any acknowledgment by

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[16] Respondents argue (AY Br. 26; AH Br. 36) that tax accrual workpapers are not relevant insofar as they are sought to further the "convenience" of the IRS in conducting an audit and provide a "roadmap" through the data and issues involved in the audit. We disagree. In fact, it is common practice with respect to subpoenas and civil discovery for the requesting party both to seek information in the most convenient form in which it exists (*e.g.*, in computer-readable form, or in summaries and compilations rather than raw data) and to seek aids to facilitate the requester's use and undertanding of other materials (*e.g.*, organization charts, indices and descriptions of files, or computer instructions used in generating data). Furthermore, as Fed. R. Civ. P. 26(b)(1) expressly recognizes, information is relevant if it "appears reasonably calculated to lead to the discovery of admissible evidence" that tends to prove or disprove any fact at issue in the litigation. The IRS, in enforcing the revenue laws, is entitled to no less latitude. Accordingly, materials that assist the IRS in conducting an audit, by focusing its attention and limited resources and by leading it to information bearing on the taxpayer's liability, are relevant.

the taxpayer that the position taken on its return was "questionable" is highly relevant to the issue of its tax liability.

Likewise, tax accrual workpapers can bear on the taxpayer's state of mind in submitting its returns, which is directly relevant to the imposition of various penalties and sanctions (see U.S. Br. 25 & n.13). This relevance is not negated, as respondents assert (AY Br. 2, 8-9; AH Br. 2, 4), by the fact that the workpapers are generally prepared subsequent to the filing of the return for a given year, for they may shed light on the taxpayer's state of mind in succeeding years. In this case, for example, the workpapers for the tax year 1972 may shed light on the taxpayer's intent if the taxpayer failed to heed the auditor's advice in its 1973 and 1974 returns. Nor do the tax accrual workpapers become irrelevant simply because the IRS did not allege fraud or other grounds for penalties at the time it issued the summons (see AH Br. 4, 5). As this Court has recognized, a tax investigation inquires into all aspects of the taxpayer's liability under the Internal Revenue Code, including its liability for fraud or other penalties, and does not require an advance determination by the IRS of reason to believe that fraud or other violations have occurred. See *United States* v. *LaSalle National Bank*, 437 U.S. at 308-309; *United States* v. *Bisceglia*, 420 U.S. at 146; *United States* v. *Powell*, 379 U.S. at 53-54, 56-58. A contrary rule would force the IRS to resolve "the very subject which [it] desires to investigate" (*id.* at 54) and necessitate " 'forecasts of the probable result of the investigation' " (*id.* at 57 (citation omitted)).[17]

Tax accrual workpapers are also relevant because they reveal the analysis and opinions of the independent auditor on the correctness of the taxpayer's return. The informed judgment of an independent certified public accountant on that question is plainly *relevant*. As the court of appeals explained (Pet. App. 27a), "[i]t is dif-

[17] We note, in addition, that the IRS was conducting both civil and criminal investigations in this case (see Pet. App. 19a-20a).

ficult to say that the assessment by the independent auditor of the correctness of positions taken by the taxpayer in his return would not throw 'light upon' the correctness of the return." See also *Matter of Newton*, 718 F.2d at 1020; *United States* v. *El Paso Co.*, 682 F.2d at 537; cf. *United States* v. *Noall*, 587 F.2d at 126. While it is not the purpose of the summons to obtain such materials (see U.S. Br. 26-27), they are plainly not irrelevant.

Finally, the tax accrual workpapers may contain discussions by the auditor and taxpayer pertaining to settlement and litigation of potential tax disputes. This information "may be relevant" under Section 7602 since it will normally incorporate or reflect an assessment of facts and their legal consequences—as, for example, where the auditor recommends that the taxpayer pay the full amount of the tax due because of the weakness of the position taken on the return. Of course, in some instances this type of information will not prove to be pertinent—for example, where the decision "not to litigate * * * [is] based on considerations wholly apart from the inherent legality of what the taxpayer has done, e.g., the cost of * * * litigation * * *" (Pet. App. 30a).[18] Indeed, as respondents point out (AY Br. 29; AH Br. 34), the Service itself has recognized that the "examiner's interest in the 'items' that make up the tax accrual does not include the independent accountant's or taxpayer's opinion of the value of issues or the likelihood of success in litigation." IRS Information Notice 80-7 (Aug. 4, 1980). But the fact that this portion of the workpapers will not be relevant in all cases does not automatically exempt it from production (or at least in camera review) and does not in any way warrant the withholding of the remainder of the papers.[19]

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[18] It is hardly a proprietary secret, however, or outside the common understanding of the IRS, that a taxpayer is unlikely to undertake costly litigation to contest relatively small tax liabilities.

[19] We emphasize that, even if some small portions of the workpapers are not relevant, the proper disposition would hardly be to

For the foregoing reasons and those stated in our opening brief, it is respectfully submitted that the judgment of the court of appeals should be reversed.

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JANUARY 1984

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withhold the materials altogether. Rather, the general rule regarding the production of documents to the government is that, at least in the absence of special considerations, the government is entitled to see the entirety of any document that contains relevant material. Even if that customary procedure were inapplicable here, at most petitioners would be allowed to withhold those portions of the workpapers—perhaps subject to in camera review by the district court—that do not meet the proper standard of relevance.

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